

## The Effects of Dependency on Debt Financing On Financial Reporting Policy: The Case of Greece

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### Abstract:

*Financial statements information is supposed to influence the credit decisions of credit institutions. Furthermore, debt agreements include terms based upon accounting numbers. Within this context an accounting choice aiming to minimize tax liability might generate significant non-tax costs for a firm. The significance of these costs is conditioned upon the level of dependency of firm on debt financing. This paper examines the arguments that have been developed regarding the association between firm's leverage ratio and its accounting policy decisions. Given the level of dependency of Greek industrial firms on bank financing it is argued that the above mentioned factors might affect the accounting policy decisions of Greek firms and prompt them to deviate from a tax-reducing policy.*

### 1. Introduction

Firms' choices of reporting policies are conditioned upon the economic consequences of the alternative policies (Dhaliwal *et al.*, 1982). Holthausen and Leftwich argue that firms' choices of reporting policies have economic consequences when:

*"...changes in the rules used to calculate accounting numbers alter the distribution of firm's cash flows, or the wealth of parties who use those numbers for contracting or decision making." (1983: 77).*

In addition, accounting figures influence firm's cash flows through their impact upon company's tax liability (Wolfson, 1993). This is the case provided that the same accounting treatment is used for financial reporting purposes and tax purposes (Cloyd *et al.*, 1996). A tax reducing strategy increases firm's tax saving and consequently has a positive effect on its cash flows. Assuming rationality and efficient capital markets, an accounting policy that minimizes taxable income should be preferred (Biddle and Lindhall, 1982; Niehaus, 1989). However, given

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that the reduction in firm's taxable income is associated with a corresponding decrease in its reported income, tax minimisation might have serious consequences for various parties involved within a firm (Scholes *et al.*, 1990). The adverse picture of the firm's financial position that may emerge as a result of a decrease in the reported figures might hinder firm's ability to meet its contractual and regulatory obligations, while shareholders' and managers' wealth may be affected as well (Matsunaga *et al.*, 1992). The above-mentioned consequences of a tax reducing policy are called the "non-tax" costs – or financial reporting costs - of that policy. The tax benefits of an accounting choice are supposed to be traded off against the non-tax costs ensuing from it. The outcome of this trade-off influences firm's accounting policy decisions.

The role that accounting figures play in firm's negotiations with the providers of credit capital, and the inclusion of accounting numbers-based terms in the debt agreements, suggest that an accounting choice aiming to minimize tax liability might generate significant non-tax costs for a firm<sup>3</sup>. The significance of these costs is conditioned upon the level of dependency of firm on debt financing. The firm's leverage ratio it has been hypothesised to be an appropriate proxy for firm's dependency on debt financing (Smith, 1993). This paper examines the arguments that have been developed regarding the association between firm's leverage ratio and its accounting policy decisions. Given the level of dependency of Greek firms on debt financing it can be assumed that the above mentioned factors might affect the accounting policy decisions of Greek firms. The paper discuss the impact that the debt-related considerations might have upon the accounting policy decisions of Greek industrial firms given the structural characteristics of the Greek business environment in general, and the banking sector in particular. It is argued that firm's dependency on debt financing is a factor that can generate significant financial reporting costs for Greek industrial firms and force them to deviate from a tax-reducing policy.

## **2. Financial reporting costs and firm's dependency on debt financing**

The use of accounting information by external providers of capital can generate important financial reporting costs. Banks analyse accounting information before taking a credit-allocation decision (Lev, 1974; Foster, 1986). Sengupta (1998) argues that financial accounting information influences banks' credit allocation decisions; while the quality of corporate disclosure has an impact upon the firm's cost of capital. The impact that accounting numbers might have on banks' credit decisions may influence a firm's reporting policy decisions

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<sup>3</sup> Other factors that influence the balance between tax benefits and non-tax costs are (i) ownership structure of the firm, (ii) the impact of accounting figures on the firm's capital value, (iii) the perceptions of external parties regarding management's efficiency and ability, (iv) the various regulatory constraints that a firm may face. For further discussion of these factors see, Scholes *et al.*, (2005).

(Deakin, 1979). Prakash and Rappaport (1977) and Dirsmith and Lewis (1982) argue that managers' perceptions regarding the impact of accounting information on the users of accounts may influence their accounting policy choices (see also Wilner, 1982). Within this context, it is reasonable to expect that the tax benefits which result from a tax-minimisation policy will be balanced against the potential non-tax costs associated with such policy (Wolfson, 1993; Cloyd *et al.*, 1996). As Wolfson (1993) argues:

*"...while the tax savings that result from reducing taxable income may be attractive, the increased costs associated with reporting reduced profitability to capital suppliers typically is not."* (p. 319)

A conflict of interests may arise between shareholders and firm's lenders (Leftwich, 1983). Managers are assumed to "...maximize the value of the firm's stock rather than the value of the firm (debt plus stock)." (Kelly, 1983, p. 117). They will aim to transfer wealth from lenders to shareholders (Holthausen, 1981; Holthausen and Leftwich, 1983). Dividend policies and financing and investment decisions, which take place after the granting of a loan, and have not been anticipated or defined in advance, might result in a transfer of wealth from lenders to shareholders (Smith and Warner, 1979). Kelly (1983) provides the following examples of wealth transfers between the two parties:

*"...management may increase dividend payments to shareholders by selling the firm's assets, issue additional bonds of equal or higher priority, undertake investment projects with a variance of return higher than indicated when the debt was issued, or reject with positive return if the benefits would accrue to the bondholders."* (p. 117)

Assuming rational expectations, the providers of debt capital are expected to anticipate these management actions, and to value the debt issue accordingly (Holthausen and Leftwich, 1983; Watts and Zimmerman, 1986; Smith, 1993). Thus, the managers have an incentive to sign contracts that will convince lenders that actions, which may reduce the value of the debt, will not be undertaken (Kelly, 1983). Often, these contracts include provisions, which are expressed in accounting terms, and put restrictions on a firm's investment, financing and other operational decisions (see, Dhaliwal, 1980; Holthausen, 1981; Leftwich, 1981, and 1983; Gopalakrishnan and Parkash, 1995). For instance, minimum requirements with respect to the level of working capital, leverage and net worth can limit a firm's discretion to "...merge, issue new debt, or pay a dividend if leverage is above the specified maximum and/or working capital is below the stated minimum." (Holthausen, 1981, p. 77). If debt covenants are violated, the firm is placed in technical default. According to Gopalakrishnan and Parkash (1995) the consequences of a violation of an accounting-based debt covenant are as follows:

*"(a) termination of the lending agreement; (b) demand for immediate repayment of the loan; (c) increased collateral; (d) increased interest rate; (e) imposition of additional constraints; and (f) waiver of the violation."* (p. 20)

It seems therefore, that a technical default can cause cash out-flows, which will most probably generate stock-price effects (Kelly, 1983). As a consequence, firms' shareholders have an incentive to avoid a violation of the terms of debt agreements. A similar incentive have the managers of a firm, since a technical default may influence their wealth, through the negative impact it will have on the value of their stockholdings, and on the value of their human capital (Kelly, 1983). Given that the terms of the debt covenants are often expressed on the basis of accounting figures, the accounting methods employed can partially determine whether a firm is able to meet the debt covenants (Holthausen, 1981; Holthausen and Leftwich, 1983). It seems, therefore, that a change in an accounting method - a mandatory or a voluntary one - can influence the wealth of shareholders and lenders (Lys, 1984).

The cost of a technical violation of a public debt is supposed to be higher than the cost of a violation of a private debt, because the cost of renegotiating a public debt is supposed to be higher in comparison to the renegotiation of a private one (Barrett *et al.* 1989; and Gopalakrishnan and Parkash, 1995). For a renegotiation of a publicly issued debt it is required a consent of debt-holders that control at least two-thirds of the outstanding debt, while for the modifications of certain specifications of the issuance the consent of total number of debt-holders is necessary (Smith and Warner, 1979; Dhaliwal, 1980; Smith, 1993). According to Smith (1993) the more costly and relatively inflexible process of the renegotiation of a publicly-issued debt can lead a firm to a bankruptcy more easily than in the case of a private debt.

It should be noticed, though, that a change in accounting methods has implications with respect to firm's ability to comply with the terms of lending contracts only if the terms relating to accounting-figures are costly to (re)negotiate. As Holthausen and Leftwich (1983) state: "A necessary condition for accounting changes to have economic consequences because of lending agreements is: it is costly to negotiate and monitor debt agreements, renegotiate those agreements, and recapitalize outstanding debt." (p. 86). Costless (re)negotiations, monitoring and recapitalisations imply that an accounting change - voluntary and / mandatory - will have no effect on the terms of the loan agreements, since particular accounting rules referring to these terms will be set in detail *ex ante* (costless negotiation). In the case of a subsequent change, lenders and borrowers can neutralise the consequences of the relevant changes by *ex post* adjusting the accounting-determined specifications of the terms (costless renegotiation). As far as the costless recapitalisation of the debt concerns, the impact of the alteration in accounting rules can be negated by a repurchase of the debt by the debt-issuer, and a subsequent reissue of it, which will incorporate the changes in the accounting provisions.

It has been hypothesised that firms, which are close to violating restrictive accounting-based covenants, are more likely to prefer accounting methods that reduce the likelihood of such events; in these situations the firm will choose

income-increasing methods (see, Dhaliwal, 1980; Holthausen, 1981; Holthausen and Leftwich, 1983; Kelly, 1983; Watts and Zimmerman, 1986; Gopalakrishnan and Parkash, 1995). The terms of lending agreements can be a determining factor in the choice of accounting methods only if the accounting-based provisions of the debt contracts relate to the generally accepted accounting principles. As Gopalakrishnan and Parkash (1995) state: "...if lending agreements do not refer to GAAP (or modified GAAP) on a consistent basis, debt covenants per se are not likely to be a major factor in accounting choice decisions." (p. 16). To specify particular accounting procedures for an individual debt contract is costly, therefore accounting methods employed for measuring the restrictions incorporated in the loan agreements are often those determined by the generally accepted accounting principles (Holthausen, 1981; Leftwich, 1983; Kelly, 1983). Empirical research provides evidence, which testifies terms of the debt agreements usually refer to GAAP (see, Duke and Hunt, 1990; Press and Weintrop, 1990; Gopalakrishnan and Parkash, 1995).

However, an accounting-method decision which aims to relax the accounting-based constraints of a loan agreement, is most likely to be associated with important tax costs, since the resulting increased reported income is likely to generate increased taxable income. Sweeney (1992) suggests that, although the adoption of an income-increasing method can delay the violation of a debt-covenant, when the method is likely to result in significant tax costs, a firm may choose the tax-reducing method, despite the likelihood of technical default. Conversely, when a firm is close to violating accounting-based terms of their debt covenants, important non-tax costs can arise from the implementation of a tax-reducing policy (see, Johnson and Dhaliwal, 1988; Matsunaga, *et al.* 1992; Wolfson, 1993; Cloyd *et al.*, 1996; Maydew, 1997).

On the other hand, the link between the technical violation and the choice of accounting methods has been questioned. Beneish and Press (1993) argue that a technical default is more likely to be associated with deterioration of a firm's real economic circumstances, rather than with a change - voluntary or mandatory - in accounting methods. They compared the financial characteristics of violating against non-violating firms, and they conclude that: "...violators present a profile consistent with financial distress. Relative to nonviolators, violators are relatively more leveraged and have lower liquidity, profitability, and stock return performance." (Beneish Press, 1993, p. 239).

Furthermore, it has been argued that the consequences of a technical default may not be that severe for a violating firm. The results of empirical research have not been conclusive. Beneish and Press (1992) investigated the costs of technical violation for a sample of firms that breached accounting-determined debt covenants. The results suggested that a technical violation could give rise to important refinancing and restructuring costs due to the lenders' decisions to increase interest rates and to demand a partial or full repayment of the loan. Furthermore, it is likely that in response to covenant violations, lenders will impose additional restrictions on the firm. On the other hand, Gopalakrishnan and Parkash (1995) findings suggest that a waiver of a violation is the more likely response to a violation - an outcome that is not so costly for a firm, in comparison

with other potential consequences that could have ensued as a result of a technical default.

Consequently, the non-tax costs associated with a tax-minimisation policy may not be as important as originally hypothesised, and thus a firm may not forego so easily potential tax benefits. However, the waiver of violation is not completely a costless result. Beneish and Press (1992) provide evidence, which suggests that although the violation is less costly for firms that can obtain a waiver than for those that cannot, waivers are not costless, since borrowers should pay fees and concessions to lenders in order to obtain a waiver. Besides, it seems that a waiver is more likely to be granted to a firm with lower estimated probability of bankruptcy and a lower leverage ratio, while unsecured or high debt issues are less likely to receive a violation waiver (Chen and Wei, 1993).

### **3. Leverage characteristics and tax planning**

It has been argued that the tax-costs might not be particularly significant for the firms that are close to breach debt-covenants. Johnson and Dhaliwal (1988) maintain that the economic conditions, which lead a firm towards a technical default, will have a negative impact on the firm's effective tax rates. The debt of the firm will have generated tax-shields in the form of high interest expenses. Furthermore, the adverse economic conditions are likely to have generated tax credits in the form of operating loss carryforwards. These tax credits will limit the tax costs that will result from an income-increasing accounting policy.

An inverse association may exist between the debt-related tax shields and other tax-shields, such as investment-related (e.g. depreciation). DeAngelo and Masoulis (1980) suggest that - holding before-tax earnings constant - when a firm enjoys high investment-related tax shields it will issue less debt, because the deductibility of the debt-related tax shields (i.e. interest expenses) will be reduced as a consequence of the existence of high investment-related tax shields - and *vice versa*. MacKie-Mason (1990) and Dhaliwal *et al.* (1992) provide evidence, which indicate that firms, which face a great probability of losing the deductibility of their existing tax shields, they are less likely to issue debt.

The substitution of alternative tax shields will take place providing that firm's earnings are not high enough to allow the simultaneous use of both tax shields. Furthermore, the substitution between the debt-related tax-shields and other tax-shields will take place provided that losses cannot be carried forward. If they can be carried forward, the tax shields are not wasted, since they can be used to offset taxable income in the future (Dhaliwal *et al.*, 1992). Furthermore, for the firms with high loss-carryforwards, the value of the tax shields may decline, if the operating income cannot "absorb" all the available tax shields (Auerbach and Poterba, 1987, in Feldestein (ed.), 1987).

When a firm faces huge prior year's losses - or operating losses - and avoids using a tax-shield not only does not waste its tax shields, but also increases the total tax savings. When a firm does not use a tax-shield, its operating income rises

and can be charged with the losses carried forward from prior years. In that way the company writes off the prior periods' losses and effectively reduces its tax liability. Since the reported profits are charged with losses carried forward, there will be no taxable income for the years that such a policy is implemented. After the end of that period, the firm can charge its profits with the tax-shield that has not used in the previous years. As a result the level of reporting profits and of taxable income will be reduced. As Scholes *et al.* (1990) put it: "...efficient tax-planning may be very different from tax minimization." (p.621)

A similar argument was developed by Bowen *et al.* (1981), with regard to the accounting treatment of the interest costs related with capital expenditures - i.e. capitalisation vs. expense. They argued that, since the expense of the interest would result in a reduction of tax liability, it would have been the obvious choice from a tax perspective. However, under certain circumstances the capitalisation of the interest may constitute an effective tax reducing policy. In particular, a "...firm with a tax loss carry forward or with a current operating loss and insufficient taxable income in the previous three years to carry back the operating loss may prefer to capitalise interest. Under these circumstances, delaying recognition of the interest expense prolongs the period over which the expense can be used to reduce taxable income." (p. 155). According to this interpretation the decision of the more leveraged firms to capitalise interest is dictated by the requirements of a tax-reducing strategy aiming to substitute tax shields over time. Such an interpretation can be perceived as distinct from an interpretation founded upon a tax benefits vs. non-tax costs analysis. However, the two interpretations are not necessarily incompatible or competing. For heavily indebted firms that benefit from the above mentioned tax shields, the decision to capitalise interest not only leads to a reduction of their long-term tax liability, but also improves their prospects to raise debt capital in favourable terms and to avoid a violation of their debt covenants, since they avoid a further deterioration of their financial condition.

#### **4. Financial reporting costs for firms operating in Greece**

In Greece bank financing constitutes one of the main sources of funds for private enterprises. Thus, firms are expected to particularly concern about the impact that accounting figures might have upon banks' credit decisions. Within this context a tax-reducing accounting policy can generate significant non-tax costs for the firms.

On the other hand, it could have been argued that the significance of the financial reporting costs resulting from a tax-reducing policy might be mitigated due to the influence of factors that have traditionally characterised the structure of the Greek business environment. During the post-war period banks had gradually developed a close relationship with many companies, which in certain cases included an ownership of firms' share capital (OECD, 1995). Actually, for decades banks have been the main – if not the only – source of finance for most of Greek business entities (see, Halikias, 1978; Tsoris, 1984). Until recently equity funds raised through capital markets played a minor role in the financing of private enterprises (OECD, 2001). The close relationship that existed between banks and companies might had as a consequence that banks could have obtained any relevant information concerning a particular entity, directly from entity's

management, without having to rely upon publicly disclosed data. Furthermore, a violation of a debt covenant might not have so serious consequences for a firm. Moreover, since most Greek firms usually preferred private debt and very rarely issued public debt, the cost of renegotiating a debt was not significant, and as a consequence the non-tax costs resulting from a violation of a debt covenant would have been limited.

For decades the banking sector in Greece was dominated by a number of large banks, which were under the direct or indirect control of the state (Mpellas and Georgopoulos, 2003). It has been argued that the loan granting decisions of the state controlled banks have not always been based upon objective financial criteria. Favouritism and clientelistic relationships influenced, in certain cases, the loan granting decisions of the state-controlled banks (OECD, 1995; Makridakis *et al.*, 1997; Papadogiannis in KATHIMERINI 2005). Consequently, the importance of publicly disclosed accounting information might have been limited. Within such a context, a tax-reducing strategy would not be likely to generate significant non-tax costs. The model of industrial development which is based upon the financing of business entities predominantly by bank credit have been implemented in most continental countries in Europe in the post-war period. Especially in countries where the capital markets were not particularly developed the banking system had been the main vehicle for the recycling of savings in the economy (Bellás and Sougiannis, 1996). Regardless of its limitations, which became apparent only recently, this model contributed in the post-war economic development of Western Europe. The adoption of this model had some consequences regarding the development of financial accounting in continental Europe. In fact, it has been argued that the fact that financial accounting in many European countries has been dominated by tax regulations and has never developed to a genuinely independent branch of accounting can be partially attributed to the fact that when "...even listed companies in continental countries are dominated by banks, governments or families, the need for published information is less clear." (Nobes and Parker, 2000, p. 21).

Besides the state, though the Central Bank imposed a strict control upon the banking system. The imposition of a tight and complex system of credit rules and regulations allowed a very limited scope for innovation and modernization, even for the banks that were not under the state control (Bellás and Sougiannis, 1996). However, during the last fifteen years or so, structural changes have taken place in the banking sector that have affected banks' credit policies, and as a consequence might have led to an increase of the non-tax costs that firms might face. A privatisation programme that has been gradually implemented during the last years has as a consequence banks that were previously under the state control, passed to the control of the private sector (Mpellas and Georgopoulos, 2003). Furthermore, even in the case of the banks that continue to be under the direct or indirect state control, state's interference in their management has been loosening in the last decade (OECD, 2002). It appears that the implementation of objective selection criteria for the granting of loans is the norm even for the state-controlled



banks (see, Emporiki Bank, Annual Report, 2004). When applying for a loan, companies are required to meet some accounting numbers-based criteria. The rules regulating the procedure of granting a loan may provide that the applying firms should meet particular criteria regarding the debt/total assets ratio and/or debt/equity ratio, while the total bank-loans should not exceed a particular level. Furthermore, the debt agreements include similar accounting-numbers based terms. During the period the loan is outstanding firm's leverage ratio should not exceed a level specified within the debt agreement. The terms of the loan-granting agreement often include provisions that forbid a firm to apply for additional loans from other banks.

The most likely outcome of a violation of debt covenant violation is the recall of total amount or part of the loan. In many cases, certain conditions relating to firm's profitability are imposed. For instance, when the level of profits before depreciation and taxes fell below determined level banks might demand a considerable increase in the collaterals provided by the enterprises. Within such a context financial reporting policy decision that has an impact on a number of accounting figures might generate significant non-tax costs.

A factor that most likely induced the state-controlled banks to abandon the older loan-granting policies has been the dramatic intensification of competition among the commercial banks during the last 10 years (Mpellas and Georgopoulos, 2003). A number of dynamic new banks that do not operate under the direct – or indirect – control of the state have entered the market and have gained a substantial market share (see, OECD 2001). These banks have adopted objective criteria of credit financing to private companies. Confronted with increased competition the state-controlled banks have preceded to reorganisation their activities (see, Emporiki Bank, 2004 Annual Report). Among the measures taken has been the rationalisation of the loan granting evaluation procedure with the inclusion of more objective criteria for the credit financing of private companies (OECD, 2001).

Another important development that took place in the banking sector during nineties, was Greek banks attempt to internationalise their activities by opening branches and / or acquiring banks abroad, especially in the neighbouring Balkan countries (OECD, 2001). This effort of expansion is still in process (see Table 1).

*Table 1: Greek Banks operating in the Southeastern Europe*

	National Bank	Alpha Bank	EFG Eurobank	Emporiki Bank	Bank of Piraeus
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Albania	X	X		X	X
Bulgaria	X	X	X	X	X
F.Y.R.O.M	X	X			
Romania	X	X	X	X	X
Serbia	X	X	X		X

Source: *Annual report of the National Bank of Greece, 2004*

According to the *2004 Annual report of the National Bank of Greece* lending by Greek banks to Southeastern European countries constitute 4,5 % of the total lending, while the profits resulting from their activities in this region constitute 6 % of their total profits. However, the cost of this expansion was significant and had a serious impact upon banks' financial position and profitability. Among the measures taken for improving banks' financial position has been the upgrading of the portfolio of loans granted by the banks. Banks aim to grant loans to clients with high level of credit worthiness, while a closer monitoring has been imposed upon the existing clients (Emporiki Bank, 2004 Annual Report). Again, stricter accounting numbers-based criteria have been adopted for the loans' allocation and for the monitoring of the debt-agreements.

The EU regulations regarding banks' capital adequacy ratios put further pressure to commercial banks to improve the quality of their portfolio of loans, and as a consequence prompted them to impose stricter rules regulating the loan-granting procedures (Gortsos, 1998; OECD, 2001). The application from 2005 onwards of the IAS, which assign emphasis on the transparency and the fair representation of firms' financial position, will most likely provide additional motive to commercial banks to adopt objective financial criteria for their loan-granting decisions.

The above-mentioned structural developments in the banking sector not only affected banks' long-granting procedures, but altered their credit policies as well. The banks had to readjust the risk composition of their loans. The structure of the loans granted by banks to the private sector has dramatically changed during the last decade. Total loans given to industry decreased as a percentage of total loans granted to private sector from 56 % in 1975 to 40 % in 1990 and 16 % in 2000 (see, Table 2).

<b>Table 2. Commercial banks' credit to industry</b>			
Year	Credit to industry as percentage (%) of total to private sector	Long term loans to industry as percentage (%) of total to industry	Long term loans to industry as percentage (%) of total to private sector
1975	56	19	10
1980	57	22	13
1985	53	25	13
1990	40	23	9

1995	30	14	4
2000	16	12	2

Source: Bank of Greece Monthly Bulletins

The “Loans and advances to industry” as a proportion of commercial banks Total Assets continues to exhibit a downward trend (see, Table 3). During the same period the lending to households increased tremendously (OECD, 2002). In the period 2000-2005 banks continue to exhibit a tendency of withdrawing from financing to industry and preferring the lending to households, while any increase in corporate lending is absorbed by commercial enterprises and tourism (National Bank of Greece, Annual Report 2004). The credit expansion to industry was weak during that period, while in December 2004 and in February 2005 a deceleration of credit to industry is recorded. In contrast, the annual growth of credit to households was strong during the period 2000-2005 (see Table 4). Total claims on business (loans and bonds) by credit institutions increased by 12,3 % in 2004 compared with 13,9 % in 2003. Meanwhile, the growth in consumer loans is faster, from 24,8 % in 2003 to 37,4 % in 2004. Mortgage loans increased at the same pace, i.e. 26,8 % in 2004 compared with 27,1 % in 2003 (Bank of Greece, 2004). The expansion in retail credit (consumer loans, mortgage loans) is a strategic choice for Greek Commercial Banks. For instance in the *2004 Annual Report* of National Bank of Greece is clearly stated with respect to the credit expansion strategy of the bank the emphasis is given in the retail credit (see also, Emporiki Bank, 2004 Annual Report). Despite the intense competition, the sector of retail credit has the largest growth margins (National Bank of Greece, Annual Report 2004). In fact, the increased profitability that Greek banks exhibited in the period 2000-2004 is mainly attributed in the rapid expansion of retail credit (National Bank of Greece, Annual Report 2004; Emporiki Bank, 2004 Annual Report).

<b>Table 3. Banks' credit to industry as a proportion (%) of their total assets</b>	
Year	
1997	6,7
1998	5,0
1999	4,8
2000	4,5

Source: Bank of Greece Monthly Bulletins

These developments have led to a very extensive restructuring of the risk profile of the funds allocated to private sector, leading to lowering of total risk of loans to private sector. As consequence of the above mentioned drastic changes it appears that the funds available to private companies have been dramatically reduced. A number of surveys have indicated that one of the major concerns of senior managers of Greek firms is the availability of funds for investments (see, Hassid, 1997; European Commission, 2002). It is reasonable to assume that the available funds would be primarily allocated to firms that have adequate level of credit-worthiness, as this is represented in the published financial statements. Therefore, corporations are expected to assign a new emphasis on accounting

figures. As a consequence, when a tax-reducing accounting policy has a negative impact upon certain accounting figures will generate significant financial reporting costs.

A distinct characteristic of the Greek business environment is the preference that banks have shown for granting the short-term loans instead of long-term ones, even for the financing of long-term investments in fixed capital. The greater profits and the fewer risks relating to short-term financing prompted banks to prefer grand short-term loans (Halikias, 1978; Tsoris, 1984). This tendency has been intensified in recent years. The long term-loans to industries as a proportion of total loans granted to industry decreased substantially during this fifteen years period from 23 % in 1975 to 12,5 % in 2000, while long term-loans to industries as a proportion of total loans granted to private sector decreased from 10 % in 1975 to 2 % in 2000 (see Table1). A typical contractual agreement for short-term loan provides that banks can recall loans within a short period of time (one year maximum), when contract violations occur. Practically, a waiver of violation is not an option for Greek private firms. It seems that the consequences of a violation of a debt covenant can be serious for a firm, increasing in this way the non-tax costs resulting from a tax-reducing accounting policy.

The fact that many private firms have limited access to long-term bank credit, have prompted many Greek firms to attempt to raise capital by issuing public debt (i.e. bonds), a practice that, as mentioned earlier, was uncommon in the recent past (Emporiki Bank, Annual Report, 2004; Bank of Greece, 2005). Given that the renegotiation cost of public debt, in case of a violation, is high this development is likely to have contributed in a further increase of the non-tax cost that a Greek firms might face.

Table 4.	Breakdown of Monetary Financial Institutions Credit to Enterprises and Households in Greece									
	Outstanding balances on 31/12/2004 (million euro)	Annual Percentage Changes								
		2001			2004				2005	
		Q4	Q4	Q4	Q1	Q2	Q3	Q4	December	February
Industry	15.676	10,2	11,5	10,4	10,2	7,5	1,8	1,1	-1,2	-2
Households	51.636	40	33,1	28,2	17,5	28,9	28,2	28	28,5	28,6

1. Housing loans	33.127	36,7	35,4	27,1	24,5	24,7	22,9	23,8	24,8	25,4
2. Consumer Loans	17.054	44,3	27,4	24,8	29,2	34,5	38,2	37,9	37,4	35
Credit Cards	7.665	62,1	37,1	27,8	24,8	23,3	23,3	23,4	23,2	21,4
Other consumer Loans	9.389	31,8	19,2	21,8	33,9	46,9	54,9	53,1	51,7	48,4
3. Other	1.455	165,5	62,6	135,7	119,2	87,5	47,6	18,8	15,9	29,7

*Source: Bank of Greece, Annual report of 2004*

As a result of the above-mentioned developments, it seems that Greek companies operate within an environment that is likely to generate high financial reporting costs. The case of the renegotiation of the debt of the Leader of Textile Industries in Greece is illustrative of the impact these developments have upon banks credit policies, and indicative of the non-tax costs that Greek firms might face. The consortium of banks that had financed the particular group imposed very strict conditions for the refinancing of the debt of the group. It should be noted that the three largest state-controlled banks are included in the consortium of banks. The banks have the option of the total recall of the loan within a six-month period in the of a debt-covenant violation. Many of the terms of the debt agreement are accounting-numbers based. In addition, a very tight monitoring mechanism has been imposed upon the group's policies (see EXPRESS, 2004).

## 5. Concluding remarks

This paper attempts to provide an insight on the way debt-related considerations might influence the accounting-policy decisions of Greek industrial firms. In Greece tax accounting and financial accounting coincide and it is expected that tax considerations will influence management's accounting policy decisions. It is argued that non-tax considerations relating to firm's leverage can influence the firms' accounting-policy decisions and prompt them to deviate from a tax-reducing policy. The structural changes that took place in the Greek business environment the last fifteen years may have increased the role that accounting information play in the banks' loan-granting decisions and as consequence increase the non-tax costs that Greek firms might face.

## 6. Suggestions for further research

An empirical investigation is required in order to identify the way tax considerations and financial-accounting policies articulate with each other, and influence the Greek firms' accounting policy-decisions. In addition, it should be investigated the possibility that the accounting policy decisions might be dictated by the requirements of a tax-minimisation strategy based upon the substitution of alternative tax-shields across time. Such an interpretation might be plausible, given that in Greece many firms are heavily dependent upon debt capital and as a consequence they benefit from high debt related tax shields. Further, in Greece

losses can be carried forward for tax purpose for a maximum period of five years, therefore firms have an incentive to substitute alternative tax-shields across time. Such an investigation can contribute in understanding the accounting policy decisions of firms operating in an accounting environment that tax accounting and financial accounting coincide. The similarities of the Greek accounting and business environment with that of other European countries means that the findings of such an investigation may be of some help in understanding the accounting policies of firms operating in other countries.

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